Supreme Court, U. S.
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No. 94-1868

In the
Supreme Court of the United States
October Term, 1994

North Carolina Power,
Petitioner,

v.

State of North Carolina ex rel.
Utilities Commission,
Respondent.

Petition for a Writ of Certiorari to the Supreme Court of North Carolina

ATTORNEY GENERAL'S BRIEF IN OPPOSITION

MICHAEL F. EASLEY
North Carolina Attorney General

Margaret A. Force*, Assistant Attorney General

North Carolina Department of Justice
Post Office Box 629
Raleigh, North Carolina 27602-0629
(919)733-7214

**Counsel of Record*

QUESTIONS PRESENTED

1. Whether the Public Utility Regulatory Policies Act of 1978 authorizes the North Carolina Utilities Commission to examine the appropriate avoided cost rate for purchases from certain cogeneration facilities by Virginia Electric and Power Company, when the issue is first presented in North Carolina in the context of a retail rate case, or whether such an examination is preempted under the Supremacy Clause of the United States Constitution by an arbitrated determination of the purchase rate approved by the Virginia State Corporation Commission, in which the Virginia arbitrator did not consider alternative sources of purchased power in setting the Virginia rate.

2. Whether the North Carolina Utilities Commission is bound by the Commerce Clause of the United States Constitution to accept without examination a purchase rate set by an arbitrator for the Virginia State Corporation Commission for electricity purchases from cogeneration facilities by a utility subject to the ratemaking authority of both North Carolina and Virginia commissions where federal statute and rules require each state regulatory authority to implement federal rules governing such purchases.

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ATTORNEY GENERAL'S BRIEF IN OPPOSITION

Respondent Michael F. Easley, North Carolina Attorney General, respectfully requests that this Court deny the petition for writ of certiorari seeking review of the opinion of the Supreme Court of North Carolina reported at 338 N.C. 412, 450 S.E.2d 896 (1994).

STATEMENT OF THE CASE

INTRODUCTION

Virginia Electric and Power Company, (Virginia Power)[1] contends this case raises a substantial federal question about the manner in which states address section 210 of the Public Utility Regulatory Policies Act of 1978 (PURPA § 210) and federal rules thereunder, and asserts that the challenged North Carolina decision conflicts with PURPA, federal rules, and federal and state decisions.[2] Virginia Power bases its position on an argument that PURPA and the federal rules require one state's regulatory authority to adopt a rate determined by a regulatory authority of another state for purchases by an electric utility from cogeneration facilities. A review of PURPA and federal rules thereunder shows that such uniformity among states is neither required nor intended. PURPA and Federal Energy Regulatory Commission (FERC) rules explicitly authorize "each" state to examine and determine rates under the federal framework for purchases by electric utilities from cogeneration facilities. 16 U.S.C. § 824a-3(f)(1988), 18 C.F.R. § 292.401(a)(1987). Nothing in the statute or federal rules obligates one state to accept a rate set by another state. Rather, the federal intent is that states should be afforded flexibility in the determina-

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[1] Virginia Power operates in North Carolina under the name North Carolina Power and serves retail customers in North Carolina as well as Virginia.

[2] PURPA § 210 requires electric utilities to purchase electric power from cogeneration and small power production facilities. 16 U.S.C. § 824a-3(a)(1988). Only cogeneration facilities are involved in this case, and no further reference will be made to small power production facilities although most provisions apply the same for both. A cogeneration facility produces electric energy and steam or some other form of useful energy, such as heat. 16 U.S.C. § 796(18)(A)(1988).

tion of purchase rates. Thus, this case follows federal requirements and does not raise a substantial federal question.

Moreover, this case is affected by particular circumstances not likely to be of general interest and is therefore not appropriate for consideration by this Court. The North Carolina decision which Virginia Power challenges was influenced by the fact that a Virginia arbitrator departed from certain requirements of the federal rules in setting the purchase rate for Virginia, resulting in a purchase rate in excess of the "avoided cost" rate[3] authorized under federal law and rules. The Virginia arbitrator's determination was based "on the unique circumstances of the proceedings" (Pet. App. 189a), circumstances which are unlikely to be duplicated in Virginia or elsewhere.

BACKGROUND

This case arises from a retail rate case before the North Carolina Utilities Commission (the North Carolina Commission). In the course of that rate case, the North Carolina Commission examined for the first time the appropriateness of the purchase rate for capacity payments made by Virginia Power to Ultra Cogen Systems (Ultra Cogen) for cogeneration facilities known as Hadson Power 11-Southampton, Hadson Power 12-Altavista, and Hadson

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[3] "Avoided cost" means the incremental costs to an electric utility which it would incur to generate power itself or purchase power from another source, but for the purchase from the cogeneration facility. *See* 18 C.F.R. § 292.101(b)(6)(1994). Rates for purchases from cogeneration facilities are set at full avoided cost, pursuant to FERC rules, unless the rates are negotiated among the parties. 18 C.F.R. §§ 292.301(b), 292.304(b)(2)(1994). When the Virginia arbitrator determined the Virginia purchase rate, he departed from the federal rules by relying only on the avoided cost of power otherwise generated by Virginia Power, and failing to consider the avoided cost of power available for purchase from other sources.

Power 13-Hopewell (the Hadson projects). (Pet. App. 35a)[4] At the time the rate case was heard, Virginia Power had not informed the North Carolina Commission about the Hadson projects or contracts for purchases from those projects, nor had it filed the contracts in North Carolina or otherwise sought approval by the North Carolina Commission of the capacity or energy costs of the projects, except in its application to include the costs in its North Carolina retail rates. (Pet. App. 35a) The rates Virginia Power paid for power from the Ultra Cogen projects had been set by arbitration over Virginia Power's objection in a proceeding before an arbitrator appointed by the Virginia State Corporation Commission (the Virginia Commission). (Pet. App. 187a-188a)

During the rate case in North Carolina, evidence was presented challenging the appropriateness of the rate Virginia Power paid Ultra Cogen for capacity. (Pet. App. 61a-76a) The North Carolina Commission considered the evidence and found that the rate determined by the Virginia arbitrator was well over twice as much as contemporaneous measures of avoided cost and was directly related to benefits expected for Virginia's economy from the cogeneration projects. (Pet. App. 74a-75a) It found that the Virginia arbitrator determined avoided cost of capacity based on an estimate of the cost of a power plant built by Virginia Power, but did not take into account other sources of purchased power.

The failure of the Virginia arbitrator to consider alternative sources of purchased power was significant. This truncated consideration was a departure from the provisions in PURPA §

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[4] Ultra Cogen has been succeeded in interest by Hadson Power and later by LG&E Development, but is referred to in the North Carolina decisions and here as Ultra Cogen.

210 and federal rules which define avoided cost by reference to other sources of purchased power as well as the cost of power generated by the utility itself. 16 U.S.C. § 824a-3(d)(1988); 18 C.F.R. § 292.101(b)(6)(1994).

The failure to consider other power sources was especially problematic because Virginia Power was then supplying most or all of its new capacity requirements by purchased power. Prior to the time the arbitration proceedings were initiated by Ultra Cogen in early November 1987, Virginia Power had received many inquiries from cogenerators and other non utility generators interested in selling power. In fact, Virginia Power received so many offers in the spring and summer of 1986, that it had instituted a solicitation process and sent letters to potential sellers in December 1986 seeking 700 megawatts of capacity. (Pet. App. 31a) From a pool of offers totalling 5,083 megawatts, several projects were selected, six of which became operational producing capacity of about 1,400 megawatts. (Pet. App. 59a) Ultra Cogen participated in the 1986 solicitation but its proposals were rejected because its proposed price was excessive and Ultra Cogen was unwilling to accept certain terms and conditions. (Pet. App. 62a) Just fifteen months later (close to the time the arbitration proceedings were filed by Ultra Cogen), another bid solicitation was initiated by Virginia Power in March 1988 in which 1,750 megawatts of capacity were sought. From a pool of offers totalling 14,653 megawatts, Virginia Power selected several projects, seven of which became operational by the time of the rate case in North Carolina, producing about 1,000 megawatts of capacity. (Pet. App. 59a) Although the 1988 solicitation was underway when the arbitrator considered the avoided cost for the Ultra Cogen facilities, he did not require Ultra Cogen to participate in the bid solicitation, nor did he consider an estimate of what other sources of purchased power might have cost. (Pet. App.

172a) Virginia Power objected, arguing other sources of purchased power in the pending 1988 bid solicitation should be considered. The Virginia Commission ratified the arbitrator's decision, though, and Virginia Power did not appeal. (Pet. App. 66a)

Virginia Power did not bring its concerns about the purchase rate to the attention of the North Carolina Commission, and when the issue arose in a rate case filed in 1992, Virginia Power argued North Carolina was preempted under PURPA from examining the appropriateness of the purchase rate set by the Virginia arbitrator. In response, the North Carolina Commission found that it was not preempted by PURPA and FERC regulations from examining the purchase rate or contracts between Virginia Power and Ultra Cogen, and found the "avoided cost" could be determined differently in North Carolina than in Virginia. It pointed out that PURPA mandates action by each state (Pet. App. 67a), and FERC regulations both afford latitude in implementation and allow state regulatory agencies to review contracts for purchases as part of their regulation of electric utilities under state law. (Pet. App. 68a, citing Regulations Implementing Section 210 of the Public Utility Regulatory Policies Act of 1978 ("Preamble"), 45 Fed. Reg. 12214 at pp. 12230-3 (1980) (Appended to this Brief at App. 8a-10a, 19a).) Further, it noted that although PURPA and FERC regulations do not allow rates greater than avoided costs, Virginia might base higher rates on state law or policy.[5]

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[5] FERC has waffled on the issue whether states may set rates in excess of avoided cost. In the preamble to its rules issued in 1980, FERC recognized the authority of states to set higher rates on the basis of state law, but said such rates were not based on PURPA. Since then, in a declaratory order issued April 14, 1988, FERC reversed its original position and declared that, prospectively, states could not impose purchase rates in excess of avoided cost. *Orange and*

(continued...)

The North Carolina Commission compared the purchase price for Ultra Cogen capacity with other contemporaneous measures of avoided costs for Virginia Power, and found the Ultra Cogen price out of line. The price difference was substantial. The annual capacity payments to Ultra Cogen average $341/kilowatt for the first fifteen years of operation, whereas the annual capacity payments average $141/kilowatt for projects which came from the 1986 solicitation, and $171/kilowatt for projects from the 1988 solicitation. The avoided costs set by the North Carolina Commission for small projects approved at the time the Hadson contracts were executed (which provide a cap on negotiated rates), would have resulted in significantly lower purchase rates for capacity. (Pet. App. 72a-73a) Moreover, the evidence showed the estimated cost for Virginia Power to build a plant and generate the power itself, on which the Ultra Cogen avoided cost was based, was a high estimate. (Pet. App. 73a)

The North Carolina Commission further found that the Virginia arbitrator's treatment of the Hadson projects was directly influenced by expected benefits from the projects unique to Virginia. It quoted the Virginia arbitrator's decision, which

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[5](...continued)
Rockland Utilities, Inc., 43 F.E.R.C. para. 61,067 (1988)(*Orange and Rockland*). The effect of that order was stayed June 16, 1988 pending completion of judicial review and issuance of a final rule in a generic rulemaking, *Orange and Rockland Utilities, Inc.*, 43 F.E.R.C. para. 61,547 (1988), *citing Administrative Determination of Full Avoided Cost under PURPA* in Docket No. RM88-6-000 (ADFAC NOPR), leaving the issue open until this year, when FERC concluded in another case that states may not impose rates exceeding avoided cost for cogeneration sales at wholesale. *Connecticut Light & Power Company*, 70 F.E.R.C. para. 61,012, *reconsideration denied*, 71 F.E.R.C. para. 61,035 (1995). The same day it issued *Connecticut Light & Power*, FERC dismissed and vacated *Orange and Rockland*, finding that circumstances had changed in New York since that decision was first issued. *Orange and Rockland Utilities, Inc.*, 70 F.E.R.C. para. 61,014(1995).

"specifically recognizes that the Hadson contracts 'reflect negotiations and rulings based on the unique circumstances of these proceedings (including that [the projects] are coal-fired cogeneration facilities in lesser populated areas of the Commonwealth).'" (Pet. App. 73a-74a) It noted that the arbitration petition filed by Ultra Cogen for one of the projects at The Lane Company indicated that the facility would burn coal expected to be from or transloaded in Virginia, that there were significant benefits to Lane and its ability to continue to operate and employ 1,200 people, that approximately $60 million would be invested in the Altavista, Virginia, area which was of critical importance to the future economic health of Lane and the City of Altavista, and that jobs and economic benefits to the community and the Commonwealth of Virginia would result. The North Carolina Commission found Virginia consumers might reasonably be asked to pay the extra costs associated with economic development benefits of the Ultra Cogen projects, but found it unreasonable for North Carolina customers to pay such extra costs. (Pet. App. 74a)

The decision of the North Carolina Commission examined Virginia Power's avoided cost using contemporaneous measures (measures reflecting avoided cost at about the time the Virginia arbitration was initiated) and found the most appropriate measure was the average cost of capacity from the 1988 solicitation. (Pet. App. 76a) Virginia Power was allowed to recover capacity payments in retail rates based on that amount.

The North Carolina Supreme Court affirmed the decision of the Commission.

REASONS WHY THE WRIT SHOULD NOT BE GRANTED

I. THERE IS NOT A FEDERAL QUESTION OR CONFLICT AT ISSUE HERE: THE NORTH CAROLINA DECISION DOES NOT VIOLATE THE SUPREMACY CLAUSE.

A. NORTH CAROLINA ACTED UNDER PROPER AUTHORITY GRANTED IN PURPA AND FERC REGULATIONS AND ITS DECISION WAS NOT PREEMPTED BY A VIRGINIA CORPORATION COMMISSION DETERMINATION.

Virginia Power contends the decision of the North Carolina Commission, affirmed by the North Carolina Supreme Court, raises important federal issues concerning the manner in which PURPA should be implemented by state regulators, and conflicts with decisions of other state and federal courts as well as the decisions of this Court. In support of these contentions, it says PURPA and FERC rules should be read to give preemptive effect to a decision of one state setting rates for purchases from cogeneration facilities, so that a second state regulatory agency is required to adopt rates set by the first without opportunity for examination or consideration of the appropriate rate by the second state. This position ignores the intent of PURPA and FERC rules prescribed thereunder.

The Supremacy Clause of the U.S. Constitution says the laws of the United States made pursuant to the constitution shall be the supreme Law of the Land. U.S. Const. Art. VI, cl. 2. Under this clause, Congress has the power to preempt state law. *Louisiana Public Service Commission v. FCC*, 476 U.S. 355 (1986). In any preemption analysis, the critical issue is the

determination of Congressional intent. *Id.*; *Northwest Cent. Pipeline v. State Corp. Comm'n of Kansas*, 489 U.S. 493, 509 (1989). *Louisiana* lists the following bases for preemption: 1) when Congress, in enacting a federal statute, expresses a clear intent to preempt state law; 2) when there is outright or actual conflict between federal and state law; 3) where compliance with both federal and state law is in effect physically impossible; 4) where there is implicit in federal law a barrier to state regulation; 5) where Congress has legislated comprehensively, thus occupying an entire field of regulation and leaving no room for the states to supplement federal law; or 6) where the state law stands as an obstacle to the accomplishment and execution of the full objectives of Congress. *Id.* (citations omitted) When a federal agency acts within the scope of its congressionally delegated authority, it may preempt state regulation. 476 U.S. at 368-369.

Congress' intent concerning the authority granted to federal and state agencies under PURPA § 210 is clear: FERC is required to prescribe rules governing arrangements between electric utilities and cogeneration facilities, after consultation with state regulators and others, 16 U.S.C. § 824a-3(a), and "*each* State regulatory authority shall, after notice and opportunity for public hearing, implement such rule (or revised rule) for *each* electric utility for which it has ratemaking authority." 16 U.S.C. § 824a-3(f)(1988) (Emphasis supplied.) Thus, under the plain language of PURPA, Congress expressly required "each" state to address arrangements between cogeneration facilities and electric utilities, by implementation of federal rules, and actions by state agencies taken in compliance with the federal rules are not preempted. Congress has not limited state implementation authority to facilities located within the state, nor has it limited the authority to one of two or more states which has ratemaking authority over a particular utility. Certainly, Congress is aware that an electric utility may be

subject to the ratemaking authority of more than one state. Thus, if uniformity were considered imperative by Congress, it would not have called for implementation of the arrangements by "each" state authority for "each" utility.[6]

FERC rules promulgated under PURPA § 210 clearly intend to grant states great latitude in the methods they use for implementation. FERC explicitly said so in the Preamble to the rules. *Preamble*, 45 Fed. Reg. at 12230 (App. 8a-9a); *also see Federal Energy Regulatory Commission v. Mississippi*, 456 U.S. 742 (1982) (*Mississippi*). The rules themselves say that states may comply with the statutory requirements of PURPA § 210 by issuing regulations, by resolving disputes on a case-by-case basis, or by taking any other action reasonably designed to implement the rules. *Id.*, 18 C.F.R. § 292.401(a)(1987).[7] FERC extended the states this latitude "partly in recognition of the important role which Congress intended to give the states under PURPA." *Southern California Edison Co.*, 70 F.E.R.C. para. 61,215 at p. 61,675 (1995) (citations omitted), *reconsidered on other grounds*, 71 F.E.R.C. para. 61,269 (1995).

FERC is charged under PURPA with prescribing such rules as it determines are necessary to encourage cogeneration. Those rules must require electric utilities to offer to sell electricity to and purchase electricity from cogeneration facilities. 16 U.S.C.

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[6] The North Carolina Commission noted in this case that a lack of uniform rate treatment is not unique to PURPA. Virginia and North Carolina may apply different methodologies for allocating costs among the states in retail rate cases with the result that Virginia Power may recover more or less than its total costs. (Pet. App. 75a)

[7] In 1992, FERC revised its rules concerning implementation to remove obsolete language. 18 C.F.R. § 292.401 (1994), 57 Fed. Reg. 21734.

§ 824a-3(a). The rules must also ensure that the rates for required purchases are just and reasonable to the electric utility's consumers and in the public interest, and are not discriminatory against cogenerators. 16 U.S.C. § 824a-3(b)(1988). The rules must not provide for a rate which exceeds the utility's "incremental cost to the electric utility of alternative electric energy," 16 U.S.C. § 824a-3(b)(1988), the equivalent of the term "avoided cost" used in FERC regulations. *American Paper Inst. v. American Elec. Power Serv. Corp.*, 461 U.S. 402 (1983)(*American Paper*); 16 U.S.C. § 824a-3(d)(1988); 18 C.F.R. § 292.101(b)(7)(1994).

The FERC rules mirror these statutory requirements. They require utilities to offer to pay purchase rates based on full avoided cost unless the rates are negotiated among the parties. *See American Paper*, 461 U.S. 402; 18 C.F.R. § 292.304(b)(2)(1994), 18 C.F.R. § 292.301(b)(1994). The determination of what those avoided cost rates should be is left to the state authorities.

The rules clearly intend to grant state regulators broad discretion in the determination of utilities' avoided costs. When promulgating its rules, FERC considered whether it should issue specific rules which state regulators would adopt without change, and rejected that approach, saying, "The Commission does not find this proposal to be appropriate at this time, and believes that providing an opportunity for experimentation by the states is more conducive to development of these difficult rate principles." 45 Fed. Reg. at 12231 (App. 9a) FERC recognized that "economic and regulatory circumstances vary from State to State and utility to utility." *Id.* at 12231 (App. 9a)

Since the federal rules were promulgated, FERC has expressly recognized in the course of several proceedings that states may use different methodologies for determining avoided

cost. *Southern California Edison Company*, 70 F.E.R.C. para. 61,215 (1995), *reconsidered on other grounds*, 71 F.E.R.C. para. 61,269 (1995); *Cogeneration Coalition of America, Inc.*, 61 F.E.R.C. para. 61,252 (1992); *Middle South Services, Inc.*, 33 F.E.R.C. para. 61,408 at p. 61,789 (1985), *reheard and clarified on other grounds*, 34 F.E.R.C. para. 61,342 (1986); *Administrative Determination of Full Avoided Costs, Sales of Power to Qualifying Facilities, and Interconnection Facilities, Proposed Regulations*, 53 Fed. Reg. 9331 (1988), FERC Statutes and Regulations para. 32,457 (1988)(ADFAC NOPR); *cf. West Penn Power Company*, 71 F.E.R.C. para. 61,153, 1995 WL 265343, at *13 (F.E.R.C.)(1995). As a result, FERC has acknowledged the avoided costs for the same project may differ in one state from another. 33 F.E.R.C. at p. 61,789; 53 Fed. Reg. 9331. Recently, while reaffirming the key role of states in setting avoided costs, FERC has expressed the need to ensure that states use procedures which ensure that purchase rates do not exceed avoided cost in light of the facts that the cogeneration industry is now developed and electric utilities are facing increasing competition. 70 F.E.R.C. at p. 61,675.

Further, FERC has expressly authorized state review of contracts between cogenerators and utilities in utility rate cases. As FERC stated in the Preamble to the Rules, "These rules, and the exemptions being provided by these rules, are not intended to divest a State regulatory agency of its authority under State law to review contracts for purchases as part of its regulation of electric utilities. Such authority may continue to be exercised if consistent with the terms, policies and practices under sections 210 and 201 of PURPA and this Commission's implementing regulations." 45 Fed. Reg. at 12233 (App. 19a).

In short, there is not any basis in PURPA § 210 or federal rules for the proposition that Congress or FERC intended that one state's avoided cost determination should preempt another state from conducting its own examination of the appropriate avoided cost in determining whether a purchase rate is reasonable.

Here, Virginia Power presented the North Carolina Commission with information about the Ultra Cogen facilities for the first time in the context of a retail rate case. The North Carolina Commission acted within its authority under the Federal Power Act to set retail rates, and under its authority in PURPA and FERC rules to examine the appropriate rate for purchases from cogeneration facilities. It concluded from the evidence that the Virginia arbitrator's decision did not consider other sources of purchased power available to the Company even though avoided cost is defined under PURPA § 210 and FERC with reference to the incremental costs of both purchased power and power generated by the Company itself. The North Carolina Commission concluded that the purchase rate set by the Virginia arbitrator was more than twice the rate which would result if other contemporaneous measures of avoided cost were used. Further, the North Carolina Commission concluded that the Virginia arbitrator was directly influenced in his decision by factors of peculiar benefit to Virginia. Therefore, the North Carolina Commission made its own determination of a reasonable rate using contemporaneous measures, and allowed that avoided cost amount in Virginia Power's retail rates. The determination, affirmed by the North Carolina Supreme Court, properly applies the federal statute and rules, and does not raise a substantial federal issue.

B. VIRGINIA HAS NOT RAISED A SUBSTANTIAL FEDERAL QUESTION AND THE NORTH CAROLINA DECISION DOES NOT CONFLICT WITH DECISIONS OF OTHER COURTS.

In support of its Petition, Virginia Power asserts a number of reasons why this Court should hear this case.

1. CONFLICT WITH VIRGINIA.

Virginia Power argues the North Carolina decision in this case puts North Carolina in conflict with Virginia. However, as shown earlier, PURPA § 210 and FERC rules do not require uniformity among states in the manner in which each implements the rules or the method by which each determines avoided costs. Moreover, the Virginia arbitrator's decision was ratified by the Virginia Commission, but was not appealed to Virginia appellate courts. (Pet. App. 11a, 192a) Hence there is not a conflict between the States of North Carolina and Virginia, as Virginia Power suggests.[8]

2. CONFLICTS WITH DECISIONS OF OTHER COURTS AND FERC.

Virginia Power further contends that the North Carolina decision "is squarely in conflict" with decisions by the Third Circuit of the Court of Appeals, FERC, and the Oklahoma

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[8] Presumably, the Virginia Commission would not support an interpretation of PURPA § 210 and FERC Rules which would give preemptive effect to a North Carolina Commission determination of avoided cost, particularly if it found the decision had failed to follow the federal rule and had taken into account economic development benefits peculiar to North Carolina.

Supreme Court.[9] Not one of the cases addresses the issue Virginia Power raises in this case, however. While the cases may support the proposition that a state should not reconsider an avoided cost rate once it has approved the rate and a binding contract has been formed, they do not presume to restrict a state from examining rates where, as here, it has not previously considered or approved the rate or contracts.

3. CONFLICTS WITH DECISIONS OF THIS COURT.

Virginia Power cites this Court's decisions in *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986) (*Nantahala*), *Mississippi Power & Light Co. v. Mississippi*, 487 U.S. 354 (1988)(*MP&L*), and *Federal Energy Regulatory Comm'n v. Mississippi*, 456 U.S. 742 (1982)(*Mississippi*) in support of its arguments that North Carolina is preempted by the Virginia arbitrator's decision. This reliance is ill-founded. In *Mississippi*, the Court found that Congress acted within its powers under the Commerce Clause when it required electric utilities to purchase power from cogenerators, and found provisions requiring states to implement mandatory FERC guidelines were not unconstitutional under principles of state sovereignty contained in the Tenth Amendment. 487 U.S. 354. While the case may be cited for the proposition that states must follow the federal statute and mandato-

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[9] *See* Petition pp. 17-18, citing *Freehold Cogeneration Associates, L.P. v. Bd. of Regulatory Comm'rs of New Jersey*, 44 F.3d 1178 (3rd Cir. 1995), *cert. pet. pending*, *New Jersey Division of Ratepayer Advocate v. Freehold Cogeneration Associates, L.P.*, Docket No. 94-1995; *Connecticut Light & Power*, 70 F.E.R.C. para. 61,027 at pp. 61,029-30 (1995); *New York State Electric & Gas Co.*, 71 F.E.R.C. para. 61,017 (1995); *Wilson v. Harlow*, 860 P.2d 293 (Okla. 1993), *cert. denied*, ___ U.S. ___, 114 S. Ct. 1067 (1994); *Smith Cogeneration Management, Inc. v. Oklahoma Corp. Comm'n*, 863 P.2d 1227 (Okla. 1993).

ry federal rules, there is nothing in the case to suggest that one state's authority to act under the rules is preempted by actions of another state authority. On the contrary, the case recognizes that state regulatory authorities are charged under the federal statute and rules with implementation of the rules. 456 U.S. at 759. Further, as this Court stated in *Mississippi*, the states are afforded latitude in the methods they may use to implement the federal rules. 456 U.S. at 751. Although this Court discussed one method -- dispute resolution on a case-by-case basis -- as a mechanism by which a state might implement the FERC rules, it also noted that the FERC rules allow states to issue regulations or take any other action reasonably designed to implement the rules. *Id.* at 751, 760. Thus, Virginia Power mischaracterizes *Mississippi* when it suggests that *Mississippi* stands for the notion that a state's duty to implement federal rules under PURPA § 210 requires implementation only by means of case-by-case dispute resolution.

The *Nantahala* and *MP&L* cases are not good support for Virginia Power's position in this Petition either. Those cases address the preemptive effect of a rate or apportionment set by FERC for a wholesale transaction subject to regulation under the Federal Power Act. 476 U.S. 953; 487 U.S. 354; 16 U.S.C. §824(b) and §824(d)(1988). That is not the case here; the Virginia arbitrator's decision was not a rate set by FERC. Virginia Power reaches beyond the intent of Congress when it suggests that a Virginia arbitrator's determination is "equivalent" to the preemptive effect of FERC orders establishing wholesale rates under the Federal Power Act.[10] As Virginia Power acknowledges elsewhere in its Petition, Congress carved out an exception to FERC's

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[10] Virginia determines rates, taking into account their impact on Virginia customers, whereas FERC is required to take into account the impact of rates on all customers.

exclusive jurisdiction over wholesale sales in interstate commerce upon the passage of PURPA. (*See* Petition at p. 6.) Under FERC regulations authorized by PURPA, the purchase price for power sold by a cogeneration facility is exempt from regulation by FERC under the relevant provisions of the Federal Power Act, 16 U.S.C. § 824a-3(e)(1988), 18 C.F.R. § 292.601(c)(1994), and the rate is determined under federal rules implemented by *each* state for utilities subject to their ratemaking authority. 18 C.F.R. §§ 292.304, 292.401(a)(1987).

Moreover, in *Middle South Services, Inc.*, 33 F.E.R.C. para. 61,408 (1985), *reheard and clarified on other grounds*, 34 F.E.R.C. para. 61,342 (1986), FERC specifically recognized that different states may use different methodologies when setting avoided cost rates for the utilities they regulate. *Middle South* raised the concern that there may be a lack of consistency in avoided cost pricing methodologies among the states, because each state commission is "charged primarily with the responsibility of protecting the economic interests of separate constituents." 33 F.E.R.C. at 61,789, *citing* Middle South initial brief (Phase II), pp. 27-28. FERC responded to this concern:

> While there clearly is potential for diverse approaches in State implementation, diversity is inherent in the latitude our rules give to States in implementing section 210. 33 FERC at 61,789.

4. DICTA IN DOSWELL.

In support of its Petition, Virginia Power also cites a FERC order addressing rates for Doswell Limited Partnership, an

independent power producer[11] which had entered agreements to sell electricity to Virginia Power. *Doswell Limited Partnership*, 50 F.E.R.C. para. 61,251 (1990) (Pet. App. 140a). Virginia Power contends that FERC "impliedly affirmed" the Virginia arbitrator's decision concerning the Ultra Cogen facilities in the *Doswell* order when it referenced the Virginia Commission decision ratifying the arbitrator's decision. It is clear, though, that the appropriateness of the purchase rate set for the Ultra Cogen facilities was not an issue raised before FERC in the Doswell case. Moreover, the purchase rate for Doswell was $146/kilowatt, while the rates for Ultra Cogen were $341/kilowatt, although both were purportedly based on estimates of the cost of constructing the same plant and Doswell has a higher capacity rating, indicating it has more attractive operating costs than the Ultra Cogen facilities. (Pet. App. 730) The difference between Doswell's purchase rate and Ultra Cogen's was that Doswell's was determined during the 1986 solicitation, whereas the purchase rates for Ultra Cogen were set without consideration of the cost of alternative sources of purchased power. In *Southern California Edison Company*, 70 F.E.R.C. para. 61,215 (1995), *aff'd in relevant part on reconsideration*, 71 F.E.R.C. para. 61,269, the FERC held that a determination of "avoided cost" does not reflect avoided cost as defined by PURPA where it uses a benchmark based only on the purchasing utility's cost of generating energy and fails to take into account what it would cost to purchase such energy from another source.

5. Use of Appropriate Date.

Virginia Power also suggests that North Carolina failed to use the right date to measure avoided cost in this case. This

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[11] Doswell is an independent generator which does not qualify as a cogeneration facility.

suggestion is not supported by the facts. The North Carolina Commission considered measures of avoided cost contemporaneous to the time the arbitration petitions were filed in November 1987. It considered the average purchase rate for capacity from contracts entered as a result of competitive bids initiated less than a year earlier in December 1986, and just a few months later in March 1988, as well as rates set by the North Carolina Commission for small projects at the time the Ultra Cogen petitions were filed. (Pet. App. 72a-73a) The bid solicitations addressed many offers Virginia Power had received for capacity throughout the period. Virginia Power implies that the difference between the rate of $341/kilowatt set for Ultra Cogen and the average rate of $171/kilowatt which came from the 1988 solicitation is due to a drop in avoided costs after the time the arbitration petitions were filed. This ignores the fact that the purchase rates produced by the 1986 solicitation averaged $141/kilowatt, even lower than those produced in the 1988 solicitation. The North Carolina Commission (and the North Carolina Supreme Court) clearly attributed the difference in rates to the facts that the Virginia arbitrator failed to consider the avoided cost of other sources of purchased power, and that he took into account economic development benefits to Virginia.

6. THE DUTIES TO ENCOURAGE COGENERATION AND PROTECT CONSUMERS.

Virginia Power suggests that North Carolina failed to consider the Virginia arbitrator's decision when it examined the purchase rate for the Ultra Cogen facilities, ignoring its obligation to encourage development of cogeneration facilities. In fact, the North Carolina Commission examined the Virginia proceedings carefully and thoroughly, and used avoided cost methodology in its analysis. While North Carolina might have deferred to the

Virginia arbitrator's determination if the propriety of the avoided cost rate had not been raised, North Carolina was faced with considerable evidence that the Virginia arbitrator's rate substantially exceeded Virginia Power's avoided cost as that cost is determined under PURPA and FERC rules. North Carolina recognized its responsibility under PURPA to limit the purchase rate to avoided cost, to ensure that the rate is just and reasonable to Virginia Power's consumers. *See* 16 U.S.C. § 824a-3(b)(1988). Accordingly, it was proper for North Carolina to examine the issue and reach a determination.

Finally, Virginia Power says that the North Carolina decision "deals a serious blow to PURPA" and PURPA will not work if the North Carolina decision is allowed to stand. By this argument, Virginia Power suggests that state determinations of avoided cost must be uniform to work. FERC decided otherwise when it refused to set a uniform federal rule in 1980. Since then, it has acknowledged repeatedly the authority of states to determine avoided cost rates. Certainly, this has not chilled the development of cogeneration facilities, an industry which has flourished in the intervening years. If lack of uniformity among state authorities becomes problematic, that is a matter to be presented to Congress or FERC for reexamination of the statute and rules.

Virginia Power's objections about North Carolina's decisions do not accurately represent an intention of Congress or FERC that one state's determination of avoided cost has preemptive effect over another state with respect to the resulting purchase rate. There is not a conflict with federal statutes, rules, or decisions; North Carolina decided properly. Certiorari is not appropriate in this case.

II. NORTH CAROLINA'S DECISION DOES NOT VIOLATE INTERSTATE COMMERCE.

Virginia Power also seeks review of this case based on an argument that the North Carolina decision violates the Commerce Clause of the United States Constitution and conflicts with federal Commerce Clause decisions. This argument lacks merit. Specific federal statutory and regulatory provisions authorize and require North Carolina to address arrangements between Virginia Power and cogenerators, and the North Carolina decision examined the arrangements in a manner consistent with the intent of those federal provisions. There is not a commerce clause violation in this case, and there is not a conflict with federal decisions.

Under Article I, § 8 [3] of the U.S. Constitution, Congress shall have the power "To regulate commerce . . . among the several states . . .". U.S. Const. Art. I, § 8[3]. Congress may confer upon the states the ability that they would otherwise not enjoy to restrict the flow of interstate commerce. *Lewis v. BT Investment Managers*, 447 U.S. 27, 44 (1980); *Southern Pacific Co. v. Arizona*, 325 U.S. 761, 769 (1945); *Middle South Energy, Inc. v. Arkansas Public Service Comm'n*, 772 F.2d 404 at 414 (8th Cir. 1985), *cert. denied*, 474 U.S. 1102 (1986). Thus, in *Mississippi*, cited earlier, this Court recognized that federal law has expressly left regulation of intrastate and retail electric power transactions to the states, although Congress has the power to regulate in that area under the Commerce Clause. 456 U.S. 742. Similarly, this Court found Congress has the power under the Commerce Clause to regulate the relationships between cogenerators and electric utilities to protect interstate commerce, 456 U.S. at 758, and Congress has explicitly divided the responsibility for regulation of such relationships between federal and state agencies, conferring on each state the authority, indeed the requirement, to

implement federally prescribed rules for each utility subject to its ratemaking authority. 16 U.S.C. § 824a-3(a),(f)(1988). Hence, the North Carolina Commission is specifically authorized by Congress to act with respect to arrangements between cogenerators and Virginia Power, and Virginia Power's argument to the contrary is untenable.

Virginia Power portrays the North Carolina decision as one based on state retail ratemaking authority, and suggests that federal provisions concerning the relationship between Virginia Power and cogenerators were disregarded by the North Carolina Commission. But as has been discussed elsewhere, this is just not the case. The facts show that the purchase rate between Virginia Power and Ultra Cogen was reviewed in North Carolina consistently with the PURPA-FERC avoided cost framework. (Pet. App. 4a-9a, 66a-69a, 72a-76a) The North Carolina Commission order considered the purchase rate set by the Virginia arbitrator, and made its own examination of an appropriate rate by analyzing alternative measures of avoided cost. North Carolina's action was within the scope of review which *each* state is authorized to conduct by PURPA and FERC regulations. *See Mississippi* at 751; 16 U.S.C. § 824a-3(f); 18 C.F.R. § 292.401(a).

Virginia Power argues that the North Carolina decision conflicts with the decision of the Federal Eighth Circuit in *Middle South Energy v. Arkansas Public Service Comm'n*, 772 F.2d 404. In that case, FERC reallocated purchase obligations of Middle South's operating companies to purchase power from a nuclear plant over the objection of the Arkansas commission, and shortly thereafter, the Arkansas commission initiated its own inquiry into the burden of high cost power associated with the plant. The court found the Arkansas proceeding was motivated by economic protectionism and violated interstate commerce. This case does not

involve such a conflict with FERC, nor does it involve economic protectionism. Congress and FERC clearly envision and authorize a role for "each" state regulatory authority in determining purchase rates for cogenerated power and nothing in PURPA or FERC rules says that one state must adopt a determination made by another state. In granting state authorities the power to implement FERC rules, Congress must have contemplated some impact on interstate commerce. There would be little point to granting authority to "each" state, if a state's exercise of this authority were not constitutionally enforceable. *Cf.*, *Northwest Central Pipeline Corporation v. State Corporation Commission of Kansas*, 489 U.S. 493, 523-524 (1989).

North Carolina has a legitimate interest in addressing avoided cost rates, both under its federal charge to implement PURPA, and in the context of state regulation of retail rates to customers. PURPA specifically limits the federal role in encouraging cogeneration when it says no rule provided pursuant to PURPA shall require rates in excess of the avoided cost to electric utilities. 16 U.S.C. §824a-3(b)(1988). If North Carolina is required to adopt Virginia rates as the Petitioner suggests -- notwithstanding a determination that Virginia's rates exceed avoided cost and take into account economic development benefits peculiar to Virginia -- this undermines the clear federal framework. Federal interstate commerce purposes are not thereby advanced.

Contrary to Petitioner's assertion that the North Carolina decision was motivated by economic protectionism, there is nothing in the facts of this case to suggest that North Carolina looked at benefits to North Carolina at all when it reviewed the Ultra Cogen project purchase rates. The North Carolina Commission order does not call for more North Carolina-located facilities, or require use of North Carolina fuels, nor is there any evidence

of a disregard for Virginia facilities. The North Carolina Commission did what it is authorized to do under PURPA: it assessed what an appropriate purchase rate would be, using contemporaneous measures of avoided cost, and allowed recovery of a purchase rate on that basis. In doing so, the North Carolina Commission used a measure of avoided cost which resulted in the smallest reduction in rates of the several measures introduced into evidence. (Pet. App. 73a)

The North Carolina decision in this case is consistent with both state and national interests. FERC acknowledges its rules promulgated under PURPA may not produce uniform results, but recognizes the benefit of experimentation by the states, and the advantage that states may take into account varying economic and regulatory circumstances. *Preamble*, 45 Fed. Reg. at 12230-1 (App. 8a-9a) If the North Carolina decision affects interstate commerce in that it applies a different regulation than Virginia, the effect is only to nullify the effect of Virginia economic protectionism. It does not compromise national goals; rather it implements them.

Moreover, this case involves facts which are unlikely to repeat themselves in other cases. Virginia Power did not seek review of the purchase rate or contracts for the Ultra Cogen facilities in North Carolina until this rate case was heard, although it disagreed with the Virginia arbitrator's determination. Virginia Power could have avoided the result in this case if it had sought contemporaneous determinations of the rate in North Carolina and Virginia. Further, it could have appealed the Virginia arbitrator's decision to Virginia courts or taken the matter to FERC for enforcement of federal rules, on the ground that the Virginia arbitrator's decision exceeded PURPA. 16 U.S.C. § 824a-3(g),(h)(1988). Virginia Power may still take steps to address the

problematic effect of the Virginia arbitrator's decision by bringing the matter to the attention of the Virginia Commission and requesting an allocation of the Ultra Cogen contract prices to Virginia ratepayers, to the extent the prices exceed federal avoided cost.[12]

For these reasons, the North Carolina decision complies with Congress' express intent requiring state implementation of federal rules governing the arrangements between cogenerators and electric utilities. There is not a substantial federal issue, nor is there a conflict with federal cases.

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[12] FERC suggested in *Middle South Services, Inc.*, 33 F.E.R.C. at pp. 61,789-790, that a multistate utility may localize the effect of an avoided cost determination by allocating the cost of purchases from qualifying facilities to the purchasing state. In another case, where one state set purchase rates in excess of avoided cost, FERC suggested localizing the effect by allocating the excessive cost to the state setting the rate above avoided cost. *Orange and Rockland*, 43 F.E.R.C. at p. 61,196. That case was stayed and later vacated on findings of changed circumstances. 43 F.E.R.C. para. 61,547; 70 F.E.R.C. para. 61,014.

CONCLUSION

In view of the foregoing, the Respondent Attorney General respectfully requests this Court deny the petition for writ of certiorari.

Respectfully submitted,

MICHAEL F. EASLEY
North Carolina Attorney General

Margaret A. Force
Assistant Attorney General

North Carolina Department of Justice
Post Office Box 629
Raleigh, North Carolina 27602-0629
(919) 733-7214

July 17, 1995

* Counsel of Record

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APPENDIX

PORTIONS OF THE PREAMBLE TO
18 CFR PART 292 . . . . . 1a

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PORTIONS OF THE PREAMBLE TO 18 CFR PART 292

DEPARTMENT OF ENERGY

Federal Energy Regulatory Commission

18 CFR Part 292

[Docket No. RM79-55, Order No. 69]

Small Power Production and Cogeneration Facilities; Regulations Implementing Section 210 of the Public Utility Regulatory Policies Act of 1978

AGENCY: Federal Energy Regulatory Commission.

ACTION: Final rule.

SUMMARY: The Federal Energy Regulatory Commission hereby adopts regulations that implement section 210 of the Public Utility Regulatory Policies Act of 1978 (PURPA). The rules require electric utilities to purchase electric power from and sell electric power to qualifying cogeneration and small power production facilities, and provide for the exemption of qualifying facilities from certain federal and State regulation. Implementation of these rules is reserved to State regulatory authorities and nonregulated electric utilities.

Effective Date: March 20, 1980

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SUPPLEMENTARY INFORMATION:
Issued February 19, 1980.

Section 210 of the Public Utility Regulatory Policies Act of 1978 (PURPA) requires the Federal Energy Regulatory Commission (Commission) to prescribe rules as the Commission determines necessary to encourage cogeneration and small power production, including rules requiring electric utilities to purchase electric power from and sell electric power to cogeneration and small power production facilities. Additionally, section 210 of PURPA authorizes the Commission to exempt qualifying facilities from certain Federal and State law and regulation.

Under section 201 of PURPA, cogeneration facilities and small power production facilities which meet certain standards and which are not owned by persons primarily engaged in the generation or sale of electric power can become qualifying facilities, and thus become eligible for the rates and exemptions set forth under section 210 of PURPA.

Cogeneration facilities simultaneously produce two forms of useful energy, such as electric power and steam. Cogeneration facilities use significantly less fuel to produce electricity and steam (or other forms of energy) than would be needed to produce the two separately. Thus, by using fuels more efficiently, cogeneration facilities can make a significant contribution to the Nation's effort to conserve its energy resources.

Small power production facilities use biomass, waste, or renewable resources, including wind, solar and water, to produce electric power. Reliance on these sources of energy can reduce the need to consume traditional fossil fuels to generate electric power.

Prior to the enactment of PURPA, a cogenerator or small power producer seeking to establish interconnected operation with a utility faced three major obstacles. First, a utility was not generally required to purchase the electric output, at an appropriate rate. Secondly, some utilities charged discriminatorily high rates for back-up service to cogenerators and small power producers. Thirdly, a cogenerator or small power producer which provided electricity to a utility's grid ran the risk of being considered an electric utility and thus being subjected to State and Federal regulation as an electric utility.

Sections 201 and 210 of PURPA are designed to remove these obstacles. Each electric utility is required under section 210 to offer to purchase available electric energy from cogeneration and small power production facilities which obtain qualifying status under section 201 of PURPA. For such purchases, electric utilities are required to pay rates which are just and reasonable to the ratepayers of the utility, in the public interest, and which do not discriminate against cogenerators or small power producers. Section 210 also requires electric utilities to provide electric service to qualifying facilities at rates which are just and reasonable, in the public interest, and which do not discriminate against cogenerators and small power producers. Section 210(e) of PURPA provides that the Commission can exempt qualifying facilities from State regulation regarding utility rates and financial organization, from Federal regulation under the Federal Power Act (other than licensing under Part I), and from the Public Utility Holding Company Act.

I. Procedural History

On June 26, 1979, in Docket No. RM79-54,[1] the Commission issued proposed rules to determine which cogeneration and small power production facilities may become "qualifying" cogeneration or small power production facilities under section 201 PURPA. Such qualifying facilities are entitled to avail themselves of the rate and exemption provisions under section 210 of PURPA; and qualifying cogeneration facilities are eligible for exemption from incremental pricing under Title II of the Natural Gas Policy Act of 1978.[2] The Commission will soon issue a final rule in Docket No. RM79-54.

As part of the rulemaking process in this docket, the Commission issued a Staff Discussion Paper[3] on June 27, 1979, addressing issues arising under section 210 of PURPA.

Public hearings on RM79-54 and the Staff Discussion Paper (RM79-55) were held in San Francisco on July 23, 1979, Chicago on July 27, 1979, and Washington, D.C. on July 30, 1979. Written comments were also received.

On October 18, 1979, the Commission issued a Notice of Proposed Rulemaking under Section 210 of PURPA in Docket No. RM79-55.[4] On October 19, 1979, the Commission made available its preliminary Environmental Assessment (EA) of the

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[1] 44 FR 38873, July 3, 1979.

[2] 44 FR 65744, November 15, 1979.

[3] 44 FR 38863, July 3, 1979.

[4] 44 FR 61190, October 24, 1979.

proposed rules in Docket Nos. RM79-54 and RM79-55. In a Request for Further Comments,[5] the Commission requested further public comment on both proposed rules, and on the findings set forth in the preliminary EA. In order to obtain the data, views, and arguments of interested parties, the Commission staff held public hearings in Seattle on November 19, 1979, in New York on November 28, 1979, in Denver on November 30, 1979, and in Washington, D.C. on December 4 and 5, 1979. The Commission also received written comment.

After consideration of the comments, the Commission Staff made available a final draft rule on January 29, 1980. State public utility commissioners were invited to comment on the draft at a public meeting held on February 5, 1980. Representatives of electric utilities were invited to comment at a public meeting held on February 8, 1980. The Commission Staff also made itself available to any other interested parties who wished to comment. All of the comments were considered in the formulation of this final rule.

In the Staff Discussion Paper and the Request for Further Comments, it was stated that any environmental effects attributable to this program would result from the combined effect of these two rulemaking proceedings. As noted previously, the Commission intends to issue final rules in Docket No. RM79-54 in the near future. At that time, the Commission will also make available its final Environmental Assessment.

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[5] 44 FR 61977, October 29, 1979.

II. Summary

These rules provide that electric utilities must purchase electric energy and capacity made available by qualifying cogenerators and small power producers at a rate reflecting the cost that the purchasing utility can avoid as a result of obtaining energy and capacity from these sources, rather than generating an equivalent amount of energy itself or purchasing the energy or capacity from other suppliers. To enable potential cogenerators and small power producers to be able to estimate these avoided costs, the rules require electric utilities to furnish data concerning present and future costs of energy and capacity on their systems.

These rules also provide that electric utilities must furnish electric energy to qualifying facilitics on a nondiscriminatory basis, and at a rate that is just and reasonable and in the public interest; and that they must provide certain types of service which may be requested by qualifying facilities to supplement or back up those facilities' own generation.

The rule exempts all qualifying cogeneration facilities and certain qualifying small power production facilities from certain provisions of the Federal Power Act, from all of the provisions of the Public Utility Holding Company Act of 1935 related to electric utilities, and from State laws regulating electric utility rates and financial organization.

The implementation of these rules is reserved to the State regulatory authorities and nonregulated electric utilities. Within one year of the issuance of the Commission's rules, each State regulatory authority or nonregulated utility must implement these rules. That implementation may be accomplished by the issuance

of regulations, on a case-by-case basis, or by any other means reasonably designed to give effect to the Commission's rules.

III. Section-by-Section Analysis

* * *

Subpart C--Arrangements Between Electric Utilities and Qualifying Cogeneration and Small Power Production Facilities Under Section 210 of the Public Utility Regulatory Policies Act of 1978

* * *

Relation to State Programs

The Commission has become aware that several States have enacted legislation requiring electric utilities in that State to purchase the electrical output of facilities which may be qualifying facilities under the Commission's rules at rates which may differ from the rates required under the Commission's rules implementing section 210 of PURPA.

This Commission has set the rate for purchases at a level which it believes appropriate to encourage cogeneration and small power production, as required by section 210 of PURPA. While the rules prescribed under section 210 of PURPA are subject to the statutory parameters, the States are free, under their own authority, to enact laws or regulations providing for rates which would result in even greater encouragement of these technologies. However, State laws or regulations which would provide rates lower than the federal standards would fail to provide the requisite encouragement of these technologies, and must yield to federal law.

If a State program were to provide that electric utilities must purchase power from certain types of facilities, among which are included "qualifying facilities," at a rate higher than that provided by these rules, a qualifying facility might seek to obtain the benefits of that State program. In such a case, however, the higher rates would be based on State authority to establish such rates, and not on the Commission's rules.

A facility which provides energy or capacity to a utility under State authority may nevertheless seek to obtain exemption from the Federal Power Act, the Public Utility Holding Company Act, and State regulation of electric utilities as available under section 210(e) of PURPA. The Commission notes that the States lack the authority to exempt a facility from the Federal Power Act or Public Utility Holding Company Act. The Commission finds no inconsistency in a facility's taking advantage of section 210 in order to obtain one of its benefits, while relying on other authority under which to buy from or sell to a utility.

* * *

Subpart D--Implementation

Summary of this Subpart

Rules in this subpart are intended to carry out the responsibility of the Commission to encourage cogeneration and small power production by clarifying the nature of the obligation to implement the Commission's rules under section 210.

These rules afford the State regulatory authorities and nonregulated electric utilities great latitude in determining the manner of implementation of the Commission's rules, provided that the manner chosen is reasonably designed to implement the

requirements of Subpart C. The Commission recognizes that many States and individual nonregulated electric utilities have ongoing programs to encourage small power production and cogeneration. The Commission also recognizes that economic and regulatory circumstances vary from State to State and utility to utility. It is within this context--in recognition of the work already begun and of the variety of local conditions--that the Commission promulgates its regulations requiring implementation of rules issued under section 210.

Because of the Commission's desire not to create unnecessary burdens at the State level, these rules provide a procedure whereby a State regulatory authority or nonregulated electric utility may apply to the Commission for a waiver if it can demonstrate that compliance with certain requirements of Subpart C is not necessary to encourage cogeneration or small power production and is not otherwise required under section 210.

Several commenters expressed their concern that State regulatory authorities would not be able adequately to implement the Commission's rules, and therefore, recommended that the Commission issue specific rules which the State regulatory authorities would adopt without change. The Commission does not find this proposal to be appropriate at this time, and believes that providing an opportunity for experimentation by the States is more conducive to development of these difficult rate principles.

Implementation

Section 210(f) of PURPA requires that within one year after the date that this Commission prescribes its rules under subsection (a), and within one year of the date any of these rules is revised, each State regulatory authority and each nonregulated

electric utility, after notice and opportunity for hearing, must implement the rules or revisions thereof, as the case may be.

The obligation to implement section 210 rules is a continuing obligation which begins within one year after promulgation of such rules. The requirement to implement may be fulfilled either (1) through the enactment of laws or regulations at the State level, (2) by application on a case-by-case basis by the State regulatory authority, or nonregulated utility, of the rules adopted by the Commission, or (3) by any other action reasonably designed to implement the Commission's rules.

Review and Enforcement

Section 210(g) of PURPA provides one of the means of obtaining judicial review of a proceeding conducted by a state regulatory authority or nonregulated utility for purposes of implementing the Commission's rules under section 210. Under subsection (g), review may be obtained pursuant to procedures set forth in section 123 of PURPA. Section 123(c)(1) contains provisions concerning judicial review and enforcement of determinations made by State regulatory authorities and nonregulated utilities under subtitle A, B, or C of Title I in the appropriate state court. These provisions also apply to review of any action taken to implement the rules under section 210. This means that persons can bring an action in State court to require the State regulatory authorities or nonregulated utilities to implement these regulations.

Section 123(c)(2) of PURPA provides that persons seeking review of any determination made by a Federal agency may bring an action in the appropriate Federal court. This distinction between Federal agencies and non-Federal agencies also applies to

review of enforcement of the implementation of the rules under section 210.

Finally, the Commission believes that review and enforcement of implementation under section 210 of PURPA can consist not only of review and enforcement as to whether the State regulatory authority or nonregulated electric utility has conducted the initial implementation properly--namely, put into effect regulations implementing section 210 rules or procedures for that implementation, after notice and an opportunity for a hearing. It can also consist of review and enforcement of the application by a State regulatory authority or nonregulated electric utility, on a case-by-case basis, or its regulations or of any other provision it may have adopted to implement the Commission's rules under section 210.

Section 210(h)(2)(A) of PURPA states that the Commission may enforce the implementation of regulations under section 210(f). The Congress has provided not only for private causes of action in State courts to obtain judicial review and enforcement of the implementation of the Commission's rules under section 210, but also provided that the Commission may serve as a forum for review and enforcement of the implementation of this program.

§292.401 Implementation by state regulatory authorities and nonregulated electric utilities

Paragraph (a) of §292.401 sets forth the obligation of each State regulatory authority to commence implementation of Subpart C within one year of the date these rules take effect. In complying with this paragraph the State regulatory authorities are required to provide for notice of and opportunity for public hearing. As described in the summary of this subpart, such implementation

may consist of the adoption of the Commission's rules, an undertaking to resolve disputes between qualifying facilities and electric utilities arising under Subpart C, or any other action reasonably designed to implement Subpart C.

This section does not cover one provision of Subpart C which is not required to be implemented by the State regulatory authority or nonregulated electric utility. This provision is §292.302 (Availability of electric utility system cost data), the implementation of which is subject to §292.402, discussed below.

Subsection (b) sets forth the obligation of each nonregulated electric utility to commence, after notice and opportunity for public hearing, implementation of Subpart C. The nonregulated electric utilities, being both the regulator and the utility subject to the regulation, may satisfy the obligation to commence implementation of Subpart C through issuance of regulations, an undertaking to comply with Subpart C, or any other action reasonably designed to implement that subpart.

Paragraph (c) sets forth a reporting requirement under which each State regulatory authority and nonregulated electric utility is to file with the Commission, not later than one year after these rules take effect, a report describing the manner in which it is proceeding to implement Subpart C.

Comments received regarding this section indicated a concern that the obligation of a State regulatory authority or nonregulated utility "to commence implementation * * * within one year * * *" did not provide any guidance as to when the process must be completed. The Commission notes that the intention of this section is that the State regulatory authorities and nonregulated utilities have one year in which to establish procedures and that at

the end of that year each State must be prepared to entertain applications. The phrase "commence implementation" is intended by the Commission to connote that implementation of these rules is a continuing process and that oversight will be ongoing.

§292.402 Implementation of reporting objectives.

The obligation to comply with §292.302 is imposed directly on electric utilities. This is different from the rest of Subpart C where the obligation to act is imposed on the State regulatory authority or the nonregulated electric utility in its role as regulator. The Commission is exercising its authority under section 133 of PURPA and other laws within the Commission's authority to require this reporting.

Any electric utility which fails to comply with the requirements of §292.302(b) is subject to the same penalties as it might receive as a result of a failure to comply with the requirements of the Commission's regulations issued under section 133 of PURPA. As stated earlier in this preamble, the data required by §292.302 will form the basis from which the rates for purchases will be derived; §292.302 is thus a critical element in this program. The Commission believes that, with regard to utilities subject to section 133 of PURPA, the Commission may exercise its authority under section 133 to require the data required by §292.302(b) on the basis that the Commission finds such information necessary to allow determination of the costs associated with providing electric services. With regard to utilities not subject to section 133, if they fail to provide the data called for in §292.302(c), the Commission may compel its production under the Federal Power Act and other statutes which provide the Commission with authority to require reporting of such data.

§292.403 Waivers.

Paragraph (a) provides for a procedure by which any State regulatory authority or nonregulated electric utility may apply for a waiver from the application of any of the requirements of Subpart C other than §292.302. (Section 292.302(d) has been revised to permit a State regulatory authority or nonregulated utility to adopt a substitute method for the provision of system cost data without prior Commission approval.)

Paragraph (b) provides that the Commission will grant such a waiver only if the applicant can show that compliance with any of the requirements is not necessary to encourage cogeneration or small power production and is not otherwise required under section 210 of PURPA.

This section is included in recognition of the need for the Commission to afford flexibility to the States and nonregulated utilities to implement the Commission's rules under section 210.

Several comments suggested that the Commission set forth procedures for considering applications for waivers which would allow formal participation by qualifying facilities in a public hearing. The commission notes that interested parties would be given an opportunity to be heard in any proceeding it conducts to determine whether or not a waiver should be granted

Subpart F -- Exemption of Qualifying Small Power Production and Cogeneration Facilities From Certain Federal and State Laws and Regulations

§292.601 Exemption of qualifying facilities from the Federal Power Act.

Section 210(e) of PURPA states that the Commission shall prescribe rules under which qualifying facilities are exempt, in part, from the Federal Power Act, from the Public Utility Holding Company Act of 1935, from the State laws and regulations respecting the rates, or respecting the financial or organization regulation, of electric utilities, or from any combination of the foregoing, if the Commission determines such exemption is necessary to encourage cogeneration and small power production. As noted in the Staff Discussion Paper, the Congress intended the Commission to make liberal use of its exemption authority in order to remove the disincentive of utility-type regulation. The Commission believes that broad exemption is appropriate.

Section 210(e)(2) of PURPA provides that the Commission is not authorized to exempt small power production facilities of 30 to 80 megawatt capacity from these laws. An exception is made for small power production facilities using biomass as a primary energy source. Such facilities between 30 and 80 megawatts may be exempted from the Public Utility Holding Company Act of 1935 and from State laws and regulations but may not be exempted from the Federal Power Act. The Commission will establish procedures for the determination of rates for these facilities in a separate proceeding.

Paragraph (a) sets forth those facilities which are eligible for exemption. Paragraph (b) provides that facilities described in

paragraph (a) shall be exempted from all but certain specified sections of the Federal Power Act.

Section 210(e)(3)(C) of PURPA provides that no qualifying facility may be exempted from any license or permit requirement under Part I of the Federal Power Act. Accordingly, no qualifying facilities will be exempt from Part I of the Federal Power Act. The Commission recently issued simplified procedures for obtaining water power licenses for hydroelectric projects of 1.5 megawatts or less, and has issued proposed regulations to expedite licensing of existing facilities.[21]

The Commission believes cogeneration and small power production facilities could be the subject of an order under section 202(c) of the Federal Power Act requiring them to provide energy if the Economic Regulatory Administration determines that an emergency situation exists. Because application of this section is limited to emergency situations and is not affected by the fact that a facility attains qualifying status or engages in interchanges with an electric utility, the Commission notes that qualifying facilities will not be exempted from section 202(c) of the Act.

Furthermore, in response to comment, the Commission has revised this paragraph to provide that qualifying facilities are not exempt from sections 210, 211, and 212 of the Federal Power Act, as required by section 210(e)(3)(B) of PURPA.

Sections 203, 204, 205, 206, 208, 301, 302, and 304 of the Federal Power Act reflect traditional rate regulation or

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[21] See Order No. 11, Simplified Procedures for Certain Water Power Licenses. Docket No. RM79-9, issued September 5, 1978, and Application for License for Major Projects--Existing Dam, Docket No. RM79-36, 44 FR 24095 (April 21, 1979).

regulation of securities of public utilities. The Commission has determined that qualifying facilities shall be exempted from these sections of the Federal Power Act.

Section 305(c) of the Act imposes certain reporting requirements on interlocking directorates. The Commission believes that any person who otherwise is required to file a report regarding interlocking positions should not be exempted from such requirement because he or she is also a director or officer of a qualifying facility.

Finally, the enforcement provisions of Part III of the Federal Power Act will continue to apply with respect to the sections of the Federal Power Act from which qualifying facilities are not exempt.

§292.602 Exemption of qualifying facilities from the Public Utility Holding Company Act and certain State law and regulation.

Under section 210(e) of PURPA the Commission can exempt qualifying facilities from regulation under the Public Utility Holding Company Act of 1935 and State laws and regulations concerning rates or financial organization. Only cogeneration facilities and small power production facilities of 30 megawatts or less may be exempted from both of these laws, with the exception that any qualifying small power production facility (i.e., up to 80 megawatts) using biomass as a primary energy source can be exempted from these laws.

The Commission has determined that where a qualifying facility is subjected to more stringent regulation than other companies solely by reason of the fact that it is engaged in the production of electric energy, these more stringent requirements should be eased through exemption of qualifying facilities. By

excluding any qualifying facility from the definition of an "electric utility company" under section 2(a)(3) of the Public Utility Holding Company Act of 1935, such facilities would be removed from Public Utility Holding Company Act regulation which is applied exclusively to electric utility companies. Moreover, by excluding qualifying facilities from this definition, parent companies of qualifying facilities would not be subject to additional regulation as a result of electric production by their subsidiaries. The Commission therefore believes that in order to encourage cogeneration and small power production it is necessary to exempt cogenerators and small power producers from all of the provisions of the Public Utility Holding Company Act of 1935 related to electric utilities.

Accordingly, paragraph (b) states that no qualifying facility shall be considered to be an "electric utility company", as defined in section 2(a)(3) of the Public Utility Holding Company Act of 1935, 15 U.S.C. §79b(a)(3).

Section 210(e) of PURPA states that qualifying facilities which may be exempted from the Public Utility Holding Company Act may also be exempted from State laws and regulations respecting the rates or financial organization of electric utilities.

The Commission has decided to provide a broad exemption from State laws and regulations which would conflict with the State's implementation of the Commission's rules under section 210.

The Commission believes that such broad exemption is necessary to encourage cogeneration or small power production. Accordingly, subparagraph (c)(1) provides that any qualifying facility shall be exempt from State laws and regulations respecting

rates of electric utilities, and from financial and organizational regulation of electric utilities. Several commenters noted that this section might be interpreted as exempting qualifying facilities from state laws or regulations implementing the Commission's rules, under section 210(f) of PURPA. In order to clarify that qualifying facilities are not to be exempt from these rules, the Commission has added subparagraph (c)(2) prohibiting any exemptions from State laws and regulations promulgated pursuant to Subpart C of these rules.

Some commenters indicated that §292.301(b)(1) might be interpreted as prohibiting a State from reviewing contracts for purchases. These commenters stated that, as a part of a State's regulation of electric utilities, a State regulatory authority needs to be able to review contracts entered into by electric utilities it regulates.

These rules, and the exemptions being provided by these rules, are not intended to divest a State regulatory agency of its authority under State law to review contracts for purchases as part of its regulation of electric utilities. Such authority may continue to be exercised if consistent with the terms, policies and practices under sections 210 and 201 of PURPA and this Commission's implementing regulations. If the authority or its exercise is in conflict with these sections of PURPA or the Commission's regulations thereunder, the State must yield to the Federal requirements. The Commission does not believe it possible or advisable to attempt to establish more precise guidelines than these. Accordingly, States which have questions in this regard should seek an interpretive ruling from the Commission's General Counsel.

Subparagraph (c)(3) provides that, upon request of a State regulatory authority or nonregulated electric utility, the Commission may limit the applicability of the broad exemption from the State laws. This provision is intended to add flexibility to the exemption.

The Commission perceives that there may be instances in which a qualifying facility would wish to have an interpretation of whether or not it is subject to a particular State law in order to remove any uncertainty. Under subparagraph (c)(4), the Commission may determine whether a qualifying facility is exempt from a particular State law or regulation.

(Public Utility Regulatory Policies Act of 1978, 16 U.S.C. §2601, et seq., Energy Supply and Environmental Coordination Act, 15 U.S.C. §791 et seq., Federal Power Act, as amended, 16 U.S.C. §792 et seq., Department of Energy Organization Act, 42 U.S.C. §7101 et seq., E.O. 12009, 42 Fed. Reg. 46267)

* * *

that QFs could be paid, under certain conditions, more than the full avoided capacity cost per kw which, for the sake of convenience, the Commission converted to a rate which was based on cents per kwh. The order provided that if QF facilities operate as reliably as Vepco's own generating units, the operators will be entitled to receive full avoided capacity payments from Vepco. However, consistent with our view that no QF should receive more than full avoided costs, we find it appropriate to insert at the appropriate point in Schedule 19 the limiting language Vepco suggested in Attachment A to its Petition. This language will eliminate the potential for any QF to receive capacity payments in excess of full avoided capacity costs.

In conclusion, the Commission finds that the petition should be denied, with the exception of the matter discussed in the immediately preceding paragraph. Accordingly,

IT IS THEREFORE, ORDERED that the Petition for Reconsideration is denied, except as noted.

APPENDIX N

Rule 29.1 Statement

North Carolina Power is the North Carolina operating division of Virginia Electric and Power Company in North Carolina. Virginia Electric and Power Company is a wholly-owned subsidiary of Dominion Resources, Inc. Virginia Electric and Power Company has no non-wholly-owned subsidiaries.